

**EXHIBIT 2**

**FILED UNDER SEAL**

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UNITED STATES DISTRICT COURT  
DISTRICT OF MINNESOTA

FAIR ISAAC CORPORATION, a	)	
Delaware corporation,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Case No. 16-cv-1054 (WMW/DTS)
	)	
FEDERAL INSURANCE COMPANY, an	)	
Indiana corporation, and ACE AMERICAN	)	
INSURANCE COMPANY, a Pennsylvania	)	
Corporation,	)	
	)	
Defendant.	)	

**EXPERT REPORT OF  
W. CHRISTOPHER BAKEWELL  
REGARDING DAMAGES**

**May 17, 2019**

Respectfully Submitted,



W. Christopher Bakewell

reinsurers.<sup>277</sup> Net amounts are reported after deducting reinsurance costs.<sup>278</sup> The originating insurer's risk exposure and profitability is based on the net amount after deducting reinsurance, as the net amount reflects the revenue and cost retained by the originating insurer. Federal's underwriting gain/loss reflects Federal's reported profit from its insurance underwriting activities after consideration of all costs incurred to generate such underwriting income.<sup>279</sup>

192. The line of business profit and loss statements identify the following revenue and expense items:

**Summary Of the Types Of Revenue And Costs  
Included In the Profit And Loss Statements**

<u>Line Item</u>	<u>Account Classification</u>	<u>Description</u>
Written Premium	Revenue	The total revenue expected to be received from the sale of an insurance policy over the term of the policy. Reflects the price paid by the customer on a cash basis. <sup>280</sup>
Earned Premium	Revenue	The amount of insurance premium reported as earned for accounting purposes based on U.S. GAAP principles and accrual-based accounting. <sup>281</sup> Customers typically pay premiums in advance, however for accounting purposes the premium is earned over the term of the insurance coverage.
Losses & LAE (Loss Adjustment Expenses) Incurred	Expense	The cost of insurance claims/losses and costs associated with claims handling (e.g., legal fees). <sup>282</sup>
Commissions/Acquisition Costs	Expense	Policy level selling commissions and costs paid to insurance brokers and agents. <sup>283</sup> Reflects a direct cost of sales of an insurance policy.

<sup>277</sup> Deposition of Kevin Harkin, March 25, 2019, p. 136.

<sup>278</sup> Deposition of Kevin Harkin, March 25, 2019, p. 136. Reinsurance is a common insurance industry practice whereby an originating insurance company transfers a portion of its risk exposure to another insurer through a reinsurance agreement. Investopedia (accessed <https://www.investopedia.com/terms/r/reinsurance.asp>).

<sup>279</sup> Interview of Mr. Harkin.

<sup>280</sup> Deposition of Kevin Harkin, March 25, 2019, p. 129.

<sup>281</sup> Deposition of Kevin Harkin, March 25, 2019, p. 129.

<sup>282</sup> Deposition of Kevin Harkin, March 25, 2019, p. 130.

<sup>283</sup> Deposition of Kevin Harkin, March 25, 2019, p. 132.

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<u>Line Item</u>	<u>Account Classification</u>	<u>Description</u>
G&A (Administrative) and TLF (Taxes, Licenses and Fees)	Expense	General and administrative expenses ( <i>e.g.</i> , administrative salaries and benefits, IT costs, general office costs). <sup>284</sup> TLF expenses include state premium taxes, licensing fees and other fees. <sup>285</sup>
Expenses Incurred	Expense	Equal to the sum of commissions/acquisition costs, G&A and TLF expenses.
Dividends Incurred	Expense	Policy holder dividends which are specific to a small number of lines of business ( <i>e.g.</i> , surety). <sup>286</sup>
Underwriting Gain/Loss	Profit	The profitability of an insurance company's underwriting operations. Calculated as earned premium less losses & LAE expenses and expenses incurred. <sup>287</sup>
Combined Ratio	Ratio	A summary financial ratio of an insurance company's underwriting profitability. Calculated as losses and LAE expenses plus expenses and dividends incurred divided by earned premiums.

193. I understand that in calculating profits, Federal is entitled to deduct the costs it incurs to generate revenue. With this understanding, I performed additional analyses of these costs. Setting aside the issue of nexus discussed above, I calculated Federal's profits following several steps, as I discuss below.

194. *First*, I calculated Federal's gross written premiums (gross revenue) associated with applications that used Blaze Advisor. I adjusted Mr. Zoltowski's analysis to exclude those applications discussed in **Section 4.2** that do not use Blaze Advisor (see above) and to exclude duplicative gross written premiums that were included in Mr. Zoltowski's analysis.

195. *Second*, I deducted Federal's reinsurance costs to determine Federal's net written premium, being the amount of premium retained by Federal. Based on the evidence produced in this matter, including my discussions with Mr. Harkin, reinsurance costs are variable costs that are directly related to the sale of insurance policies. Therefore, these costs are an appropriate

<sup>284</sup> Deposition of Kevin Harkin, March 25, 2019, p. 134.

<sup>285</sup> Deposition of Kevin Harkin, March 25, 2019, p. 57-58, 134.

<sup>286</sup> Deposition of Kevin Harkin, March 25, 2019, p. 144.

<sup>287</sup> Deposition of Kevin Harkin, March 25, 2019, p. 135.

deduction in arriving at Federal's profits. I estimated Federal's reinsurance costs based on Federal's actual reinsurance costs as reported in the profit and loss statements for the relevant business segments and lines of business.

196. *Third*, I adjusted the net written premiums to reflect the amount of earned premiums. The difference between written premium and earned premium is principally timing related and related to differences between cash (written) and accrual (earned) based accounting. I adjusted the net written premiums to earned premiums based on the actual relationship between net written premiums and earned premiums as reflected in Federal's profit and loss statements for the relevant business segments and lines of business.
197. *Fourth*, I deducted losses and LAE expenses incurred by Federal associated with the earned premiums. Losses and LAE expenses are direct variable costs that directly relate to the earned insurance premiums. Losses and LAE expenses reflect the direct cost of claims associated with the earned insurance premiums and are therefore an appropriate deduction. I estimated the losses and LAE expenses based on Federal's actual loss ratio as reported in the profit and loss statements for the relevant business segments and lines of business. The loss ratio is a standard industry measure of losses as a percentage of earned premiums. I adopted the following loss ratios (*see also Exhibits 8.0, 8.1, 8.2, 8.3 and 8.4*):

Comparison of the Loss Ratios Between Business Segment/Line of Business Financials and Comparable Public Companies			
	For the Years Ending December 31,		
	2016	2017	2018
<b>Business Segment/Line of Business</b>			
<b>Financials</b>	53%	58%	56%
<b>Comparable Public Companies [1]</b>			
Low	58%	63%	62%
<b>Median</b>	<b>61%</b>	<b>66%</b>	<b>64%</b>
High	85%	83%	76%
<b>Average</b>	<b>66%</b>	<b>69%</b>	<b>66%</b>

**Note:**

[1] Includes Chubb Limited; The Travelers Companies, Inc.; The Hanover Insurance Group, Inc.; American International Group, Inc.; and W.R. Berkley Corporation

198. As summarized in the above table, Federal's actual loss ratio is generally consistent, albeit lower, than the observed range in industry benchmark loss ratios and the loss ratios of comparable public companies. Adopting Federal's actual loss ratio is conservative, meaning that if I adopted the higher loss ratios observed in industry benchmarks and comparable public companies, the losses would be higher and the underwriting profit would be smaller.
199. *Fifth*, I deducted commissions expenses incurred by Federal. Commissions expenses comprise the direct selling costs of the insurance policies and are therefore appropriately deducted as a direct variable cost. I estimated Federal's commissions expenses attributable to the subject earned premiums based on Federal's actual reported commissions expenses as a percentage of earned premiums as reported in the profit and loss statements for the relevant business segments and lines of business.
200. *Sixth*, I deducted general and administrative expenses and taxes, licenses and fees incurred. These expenses represent expenses that are necessary for the operation of Federal's business and sale of insurance policies. General and administrative expenses include underwriter salaries and benefits, professional fees and advertising and marketing costs among other expenses. These costs are necessary to operate Federal's business and sell insurance policies (gross written premium). Taxes, licenses and fees are similarly necessary costs of operating as an insurance company. I understand that these costs cannot be attributed to specific insurance policies, but are allocated to the lines of business.<sup>288</sup>
201. I estimated Federal's general and administrative expenses and taxes, licenses and fees incurred based on Federal's actual reported expenses as a percentage of earned premiums as reported in the profit and loss statements for the relevant business segments and lines of business as follows (*see also Exhibits 8.0, 8.1, 8.2, 8.3 and 8.4*):

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<sup>288</sup> Deposition of Kevin Harkin, March 25, 2019, p. 56-58.

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**Comparison of the Expense Ratios Between Business Segment/Line of Business  
Financials and Comparable Public Companies**

	<b>For the Years Ending December 31,</b>		
	<b>2016</b>	<b>2017</b>	<b>2018</b>
<b>Business Segment/Line of Business</b>			
<b>Financials</b>	27%	29%	28%
<b>Comparable Public Companies [1]</b>			
Low	30%	29%	29%
<b>Median</b>	<b>33%</b>	<b>33%</b>	<b>32%</b>
High	34%	34%	36%
<b>Average</b>	<b>32%</b>	<b>32%</b>	<b>32%</b>

**Note:**

[1] Includes Chubb Limited; The Travelers Companies, Inc.; The Hanover Insurance Group, Inc.; American International Group, Inc.; and W.R. Berkley Corporation

202. As summarized in the foregoing table, Federal's actual expense ratio is generally consistent, albeit on the low end, of the observed range in industry benchmark expense ratios and the expense ratios of comparable public companies.<sup>289</sup>
203. The following table summarizes Federal's underwriting profits from estimated gross written premiums that processed through Blaze Advisor applications and compares them to Mr. Zoltowski's estimate (*see* also **Exhibit 5**):

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<sup>289</sup> Again, adopting Federal's actual expense ratio is conservative, meaning that I were to adopt the higher expense ratios observed in industry benchmarks and comparable public companies, the expenses would be higher and the underwriting profit would be smaller.

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**Comparison of the Profit and Loss Statements for Gross Written Premiums  
Processed Through the Blaze Advisor Applications Between Mr. Zoltowski  
and Federal Actual**  
(in US\$ millions)

	<b>Mr. Zoltowski's Estimate</b>	<b>Federal Actual</b>
<b>Gross Written Premiums</b>	<b>\$ 30,876</b>	<b>\$ 16,189</b>
Net Written Premiums		\$ 14,688
<b>Net Earned Premiums</b>		<b>\$ 15,364</b>
Less: Losses		\$ (8,560)
Loss Ratio		56%
Less: Expenses (incl. commissions, G&A, taxes, dividends & other expenses)		\$ (4,348)
Expense Ratio		28%
<b>Underwriting Profit</b>		<b>\$ 2,456</b>
% of Net Earned Premiums		16%
Combined Loss Ratio		84%

204. Federal's underwriting profit calculations show a combined ratio of 84%. This combined ratio is consistent with industry benchmarks and comparable public companies (*see Exhibit 10*).

205. To recap, and absent establishing an economic nexus or causal link between any profits Federal received and the alleged infringement, a calculation of Federal's profits is inappropriate in these circumstances. As I discussed above, from a financial perspective my analysis is overinclusive relative to the claims in this case. By this I mean that it does not isolate gross written premiums and associated profits (if any) attributable to the alleged infringement, as opposed to other factors unrelated to any alleged infringement.

#### **4.4 Summary**

206. As I discussed at length above, Mr. Zoltowski's calculations are not tied to the allegations in this case. Both his "lost license fees" calculations and his "disgorgement" calculations lack